

Internal Revenue Service  
District  
Texas 75242  
Director

Department of the Treasury  
1100 Commerce St., Dallas,

Date: JAN 8 1997

Employer ID Number:

Person to Contact:

Telephone Number:

Refer Reply To:

Dear Sir or Madam:

We have considered your application for recognition of exemption from Federal income tax under section 501(c)(4) of the Internal Revenue Code.

The information submitted indicates that you incorporated in [REDACTED] on [REDACTED]. Article IV of your Articles of Incorporation states that you are formed for the purposes of providing for the maintenance and preservation of the properties subject to the Declaration of Covenants, Conditions and Restrictions applicable to [REDACTED] a subdivision in [REDACTED] and to promote the health, safety and welfare of the residents within the subdivision.

Article V of your Articles of Incorporation states that each person or entity who is a record owner of a fee or undivided fee interest in any property which is subject by the Declaration to assessment by you, shall be a member of your Association.

Your Form 1024, Application for Recognition of Exemption, states that you are made up of [REDACTED] parcels with [REDACTED] occupied residences and an estimated population of [REDACTED]. The subdivision includes a number of commercial units.

Your activities include:

- Maintaining esplanades, entrances, roadsides and common areas;
- Maintaining and operating a swimming pool and bathhouse which is available to your members and their guests;
- Contracting with [REDACTED] to provide security services for your subdivision in conjunction with [REDACTED] a master service association;

- Providing street lights on all the public roads in your subdivision;
- Maintaining a park and playground area;
- Monitoring and enforcing deed restrictions through a management company;
- Providing pest control in the common areas;
- Easter egg hunts, Christmas party, crimewatch program, and teen and adult parties for your members.

Your financial income includes dues and assessments of members, investment and other income. The primary expenses are esplanade and landscaping, streetlights, utilities, security, swimming pool, management fees, maintenance, insurance, and legal. The security and swimming pool expenses are the largest, and the amounts are as follows:

	██████████	██████████	██████████	██████████
Security	\$ ██████████	\$ ██████████	\$ ██████████	\$ ██████████
Swimming pool	██████████	██████████	██████████	██████████
Total expenses	██████████	██████████	██████████	██████████
Sec. & Swim Pool	██████████	██████████	██████████	██████████
Total expenses	██████████	██████████	██████████	██████████

Correspondence dated ██████████ states the following:

- There are ██████████ residential members and ██████████ commercial member tracts within your subdivision;
- Residential members were assessed \$██████████ in ██████████;
- Commercial members were assessed \$██████████ per commercial unit. ██████████ was assessed \$██████████ and \$██████████, ██████████ was assessed \$██████████ in ██████████;
- The subdivision contains approximately ██████████ acres. One church, one daycare preschool and various businesses are within or on your boundary;
- The park is open to the general public;
- The Easter egg hunts, Christmas parties, and teen and adult parties are for your members.

Your correspondence dated ██████████ states that you have one

commercial member - [REDACTED]

Section 501(c) of the Code describes certain organizations exempt from Federal income tax under section 501(a) and reads, in part, as follows:

"(4) Civic leagues or organizations not organized for profit but operated exclusively for the promotion of social welfare, or local associations of employees, the membership of which is limited to the employees of a designated person or persons in a particular municipality, and the net earnings of which are devoted exclusively to charitable, educational, or recreational purposes."

Section 1.501(c)(4)-1 of the regulations provides, in part, as follows:

"(a)(1) In general. A civic league or organization may be exempt as an organization described in section 501(c)(4) if -

- (i) It is not organized or operated for profit; and
- (ii) It is operated exclusively for the promotion of social welfare."

"(a)(2)(i) An organization is operated exclusively for the promotion of social welfare when it is primarily engaged in promoting, in some way, the common good and general welfare of the people of the community. An organization embraced within this section is one which is operated primarily for the purpose of bringing about civic betterments and social improvements \*\*\* The promotion of social welfare does not include direct or indirect participation or intervention in political campaigns on behalf of or in opposition to any candidate for public office. Nor is an organization operated primarily for the promotion of social welfare if its primary activity is operating a social club for the benefit, pleasure, or recreation of its members, or is carrying on a business with the general public in a manner similar to organizations which are operated for profit.\*\*\*"

Revenue Ruling 72-102, 1972-1 C.B. 149 describes an organization formed by a developer to preserve the appearance of a housing development and to maintain streets, sidewalks and common areas for the use of the residents, which was found to be exempt under Internal Revenue Code section 501(c)(4). The rationale behind this decision was that the organization served the common good and general welfare of the entire community because it owned and maintained certain non-residential, non-commercial properties of the type normally owned and maintained by municipal governments. Administering and enforcing covenants for preserving the architecture and appearance of a housing development was incidental to the overriding public benefit.

Revenue Ruling 74-99, 1974-1 C.B. 131 modified Revenue Ruling 72-102. It provides that in order to qualify for exemption under IRC 501(c)(4), a homeowners' association:

- must serve a "community" which bears a reasonable recognizable relation to



- an area ordinarily identified as governmental
- must not conduct activities directed to the exterior maintenance of private residences
- and the common areas or facilities it owns and maintains must be for the use and enjoyment of the general public.

According to this revenue ruling, a community within the meaning of section 501(c)(4) is not simply an aggregation of homeowners bound together in a structured unit formed as an integral part of a plan for the development of a real estate subdivision and the sale and purchase of homes therein. The term "community" as used in section 501(c)(4) has traditionally been construed as having reference to a geographical unit bearing a reasonably recognizable relationship to an area ordinarily identified as a governmental subdivision or a unit thereof. The revenue ruling was intended only to approve ownership and maintenance by a homeowners' association of such areas as roadways and parklands, sidewalks, and street lights, access to, or the use and enjoyment of which is extended to members of the general public, as distinguished from controlled use or access restricted to the members of the homeowners' association.

According to Revenue Ruling 80-63, 1980-1 C.B. 116, no hard and fast rule can be applied as to what constitutes a "community," but that each case must be examined to determine whether the activities of the organization have sufficient community benefit to serve a social welfare purpose under IRC 501(c)(4). Although the area represented by an association may not be a community, if the association's activities benefit a community, it may still qualify for exemption. For instance, if the association owns and maintains common areas and facilities for the use and enjoyment of the general public as distinguished from areas and facilities whose use and enjoyment is controlled and restricted to members of the association then it may satisfy the requirement of serving a community.

Question 2 of the Revenue Ruling 80-63, asks whether a homeowners' association which represents an area that is not a community qualifies for exemption under IRC 501(c)(4) if it restricts the use of recreational facilities to its members. The answer given is no. The use and enjoyment of the common areas owned and maintained by a homeowners' association must be extended to members of the general public, as distinguished from controlled use or access restricted to the members of the association.

The Rancho Santa Fe Association v. U.S. court case involves Rancho Santa Fe, a large, self-contained housing development. It consists of about 3,000 members who are property owners within the development. The property contained in the development consists of 5,100 acres. The association oversees the governance of the property within the development by enforcing the covenants and setting up various boards, including a planning board, a park board, a health board, a library board, and a recreation board. It also functions as a liaison between the community and the Board of Supervisors on issues which require the

participation of larger governmental entities, such as maintenance of the rights-of-way and the sanitation system. Rancho Santa Fe has its own post office and zip code. Not all of the common areas and facilities the Association owned and maintained were open to the members of the general public for their use and enjoyment.

The development was found to be coextensive with the community it served, and therefore, the benefits bestowed by the Association on the development benefit the general public within the requirements of the statute. Exemption under section 501(c)(4) was recognized.

The Flat Top Lake Association, Inc. v. U.S. court case involves Flat Top Lake, a housing development. It maintains and operates a lake and other recreational facilities for the pleasure and convenience of its members. Flat Top Lake lacks certain indicia of a community such as churches, schools or stores. Entrance to the Associations' property and use of its facilities is strictly limited to members and their guests. It has a sign on its entrance that states: "Flat Top Lake Association, Private Property, Members Only." The Association does not meet the requirements of exemption set out in 501(c)(4).

On the basis of the information submitted, we have concluded that you do not meet the requirements for exemptions as a social welfare organization described in section 501(c)(4) of the Code. Contrary to the requirement of the Internal Revenue Code 501(c)(4) and Regulations 1.501(c)(4)-1, your organization is not organized exclusively for social welfare purposes. You are not a community like the Rancho Santa Fe Association. You have [redacted] residential members and one commercial member, and consist of [redacted] acres. Rancho Santa Fe has 3,000 members and consists of 6,100 members. You are a housing subdivision with few commercial businesses located within your boundaries. A [redacted] acre housing subdivisions does not equate to a geographical unit bearing a reasonably recognizable relationship to an area ordinarily identified as a governmental subdivision or a unit or district thereof, as required by Revenue Ruling 74-99. Rancho Santa Fe is self contained. It functions as a liaison between the community and the Board of Supervisors on issues which require the participation of larger governmental entities. Since you are not like the Rancho Santa Fe Association, you are not a community.

For the period [redacted] through [redacted] percent of your expenses were for the security services and the maintenance and operation of the swimming pool. The deed restrictions, Easter egg hunts, Christmas parties, and teen and adult parties also privately benefit your members. Since these services and facilities are for your members, you operate primarily for the private benefit of your members. Providing benefits to a narrow group of residents is not considered promoting social welfare.

You are like the organization described in question 2 of Revenue Ruling 80-63. You are not a community, and you and operate primarily for the private benefit of your members. Providing security services which are in addition to those



already provided, and recreational facilities for your members, is for their private benefit. Any benefits to the community are not sufficient to meet the requirement that you be operated primarily for the common good and general welfare of the community. Your services do not benefit a community.

Since you operate primarily for the private benefit of your members, you are like to the Flat Top Lake Association, which did not qualify for exemption.

Accordingly, it is held that you are not entitled to exemption from Federal income tax as an organization described in section 501(c)(4), and you are required to file Federal income tax returns on Form 1120.

As a homeowners association, you may qualify for treatment under section 528. In this letter we are not ruling on whether you qualify for treatment under section 528. However, if you believe you qualify for such treatment, you should file Form 1120-H when due.


If you do not agree with these conclusions, you may, within 30 days from the date of this letter, file in duplicate a brief of the facts, law, and argument that clearly sets forth your position. If you desire an oral discussion of the issue, please indicate this in your protest. The enclosed Publication 892 gives instructions for filing a protest.

If you do not file a protest with this office within 30 days of the date of this report or letter, this proposed determination will become final.

If you agree with these conclusions or do not wish to file a written protest, please sign and return Form 6018 in the enclosed self-addressed envelope as soon as possible.

If you have any further questions, please contact the person whose name and telephone number are shown at the beginning of this letter.

Sincerely,

  
Bobby E. Scott  
District Director

cc: 

Enclosures:  
Publication 892  
Form 6018

INTERNAL REVENUE SERVICE

Midstates Region

Department of the Treasury

Appeals Office  
55 North Robinson, Suite 939  
Oklahoma City, Oklahoma 73102

Date: JUN 13 1997

Person to Contact: [REDACTED]

Telephone Number: [REDACTED]

Key District: [REDACTED]

Years: [REDACTED]

Dear Sir:

We considered your appeal of the adverse action proposed by your Key District Director. Your application for exemption from Federal income tax under Section 501(c)(4) of the Internal Revenue Code is denied.

Your denial is based primarily on the fact that your organization primarily serves the private interests of your commercial and residential members by maintaining their property. Any benefits to the community are not sufficient to meet the requirement that an organization described in section 501(c)(4) of the Code be operated primarily for the common good and general welfare of the people of the community.

You are required to file a Federal income tax return on Form 1120 for the above year. You should file this return with your District Director, Dallas Key District Office, EP/EO Division, within 60 days from the date of this letter, unless a request for extension of time is granted.

You may direct questions about the decision to the appeals officer whose name and telephone number are shown above.

Sincerely,



Ralph G. Messenger  
Associate Chief, Appeals

cc: [REDACTED]